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INFO OCT-01 EA-06 ISO-00 AID-05 CEA-01 CIAE-00 COME-00

EB-07 FRB-03 INR-07 IO-10 NEA-09 NSAE-00 OPIC-03

SP-02 TRSE-00 CIEP-01 LAB-04 SIL-01 OMB-01 STR-01

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E.O.11652: N/A

TAGS: ECON, OECD

SUBJECT: EDRC ANNUAL REVIEW OF NEW ZEALAND

REFS: (A) USOECD 4744

(B) STATE 045865

(C) STATE 047304

(D) OECD DOCUMENT EDR(75)4

1. SUMMARY. FIRST EDRC REVIEW OF NEW ZEALAND ECONOMY TOOK PLACE MARCH 4. N.Z. DELEGATION, LED BY C.H.TERRY, ASSISTANT SECRETARY OF TREASURY, STRESSED VULNERABILITY OF N.Z. ECONOMY TO MAJOR COUNTRIES' USE OF DEMAND RESTRAINT AS ANTI-INFLATION DEVICE, AND URGED RAPID RECOVERY IN THOSE COUNTRIES AS BEST MEANS OF STIMULATING N.Z. ECONOMY AND RESOLVING BALANCE-OF-PAYMENTS DISEQUILIBRIUM. EDRC RECOGNIZED DIFFICULTIES OF DEPENDENT ECONOMIES LIKE N.Z., BUT NOTED THAT N.Z. COMMITMENT TO DOMESTIC FULL EMPLOYMENT AND CONCENTRATION ON LIMITED RANGE OF EXPORTS INCREASED ITS VULNERABILITY TO FLUCTUATIONS IN EXTERNAL BALANCE. ON TRADE POLICY, N.Z. DELEGATE SAID HIS GOVERNMENT WOULD RESIST CURRENT PRO-

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POSALS TO INCREASE SCOPE OF IMPORT CONTROLS, BUT HELD

OUT LITTLE HOPE FOR LIBERALIZATION OF EXISTING CONTROLS UNDER PRESENT CIRCUMSTANCES. END SUMMARY.

2. GENERAL OUTLOOK: N.Z. DEL UNABLE PROVIDE SPECIFIC FORECASTS OF DEMAND AND PRICE DEVELOPMENTS IN 1975, BUT OFFERED ESTIMATES THAT REAL GNP WOULD RISE SOMEWHERE BETWEEN 1 AND 2 PERCENT IF USUAL FULL EMPLOYMENT OBJECTIVE WAS TO BE ACHIEVED. THIS FIGURE ASSUMED INTRODUCTION OF FURTHER DEMAND STIMULUS IN FORTHCOMING BUDGET AND USE OF MORE EXPANSIVE MONETARY POLICY. N.Z. DEL UNABLE TO COMMENT ON PRICE OUTLOOK, BUT ACCEPTED SECRETARIAT ESTIMATE THAT PRICES WOULD AGAIN RISE BY 12-14 PERCENT IN 1975. HE WAS OPTIMISTIC ABOUT ABILITY TO HOLD DOWN WAGE INCREASES, BUT EMPHASIZED THAT ONE-THIRD OF DOMESTIC PRICE RISE WAS DUE TO IMPORT PRICES WHICH WERE BEYOND CONTROL OF N.Z. UNEMPLOYED CURRENTLY ABOUT 3,000 PERSONS, BUT COULD REACH 10,000 (1 PERCENT OF LABOR FORCE) BY END OF YEAR. GNZ HAS NO INTENTION OF LETTING THIS HAPPEN AND WILL INTRODUCE JOB CREATION PROGRAMS IF NECESSARY.

3. FARM SECTOR OUTLOOK: MAIN CONCERN FOR GNZ IS VERY SERIOUS RECENT DECLINE IN FARM INCOMES DUE TO FALLING WORLD COMMODITY PRICES. N.Z. WILL GIVE TOP PRIORITY TO SUPPORT OF FARM SECTOR INVESTMENT BY MEANS OF FERTILIZER SUBSIDIES AND INCOME STABILIZATION SCHEME (WHICH WILL ADD \$50 MILLION TO GOVERNMENT EXPENDITURE FOR 1974-75). OTHER ALTERNATIVE OF CURRENCY DEVALUATION TO IMPROVE EXPORTERS' COMPETITIVE POSITION IS NOT FAVORED BECAUSE OF ADVERSE EFFECTS ON IMPORT PRICES.

4. POLICY ISSUES: N.Z. DEL MADE CLEAR THAT MAINTENANCE OF FULL EMPLOYMENT WAS HIGHEST SOCIAL AND ECONOMIC PRIORITY, OUTRANKING PRICE STABILITY AND BP EQUILIBRIUM. HE MINCED NO WORDS IN CRITICIZING USE BY MAJOR COUNTRIES OF DEMAND RESTRAINT AS PRIME ANTI-INFLATION WEAPON, CITING SEVERE IMPACT ON N.Z. EXPORT PROSPECTS AND DOMESTIC LEVELS OF ECONOMIC ACTIVITY. HE POINTED OUT THAT PRICE AND INCOME CONTROLS, AS USED BY N.Z., WERE LESS DAMAGING TO REST OF WORLD THAN DEMAND DEFLATION. HE LIMITED OFFICIAL USE

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ALSO URGED THAT MAJOR COUNTRIES MOVE TO TURN AROUND THEIR SAGGING ECONOMIES, SINCE ANY RECOVERY IN N.Z. ECONOMIC ACTIVITY WOULD HAVE TO BE EXPORT LED. N.Z. NOT PREPARED TO BALANCE ITS EXTERNAL ACCOUNTS BY MEANS OF CONTAINING DOMESTIC DEMAND AND IS WILLING TO ACCEPT EXTERNAL DEFICITS AS PRICE OF MAINTAINING DOMESTIC ACTIVITY AT LEVELS SUFFICIENT TO ASSURE FULL EMPLOYMENT.

5. OECD SECRETARIAT VERY SYMPATHETIC TO N.Z. PREDICAMENT IN FACE OF WORLD RECESSION. IT WAS CONSIDERABLE ACHIEVEMENT TO MAINTAIN FULL EMPLOYMENT UNDER THESE CIRCUMSTANCES AND STILL KEEP INFLATION ON PAR WITH MOST OTHER OECD COUNTRIES. SECRETARIAT AGREED THERE WAS NO VIRTUE IN LETTING UNEMPLOYMENT SKYROCKET AS PRICE OF CONTROLLING INFLATION, ESPECIALLY WHEN EFFEC-

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SP-02 TRSE-00 CIEP-01 LAB-04 SIL-01 OMB-01 STR-01

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TIVE PRICE AND INCOMES MECHANISM EXISTS. NOR WAS IT SENSIBLE TO COMPENSATE FOR EXPORT FLUCTUATIONS BY IMPOSING DOMESTIC DEMAND RESTRAINT. SECRETARIAT THOUGHT STRUCTURAL CURRENT ACCOUNT DEFICIT WAS ACCEPTABLE FOR COUNTRY AT NEW ZEALAND'S STAGE OF DEVELOPMENT, BUT WONDERED IF RECENT RATE OF EXPANSION HAD NOT BEEN TOO RAPID. N.Z. DEL AGREED THAT 1972-74 GROWTH RATE HAD LED TO EXCESSIVE IMPORT BOOM, BUT LATTER WAS UNDERSTANDABLE REACTION TO PENT UP DEMAND (ESPECIALLY BY FARMERS) RESULTING FROM PROTRACTED PERIOD OF TERMS OF TRADE DETERIORATION.

6. EDRC COUNTRY DELS WERE LESS WILLING THAN SECRETARIAT TO GIVE APPROVAL TO N.Z. POLICY STANCE. GERMAN DEL SUGGESTED THAT N.Z. WOULD NOT BE SO VULNERABLE TO STABILIZATION POLICIES OF MAJOR COUNTRIES IF IT TOOK STEPS TO DIVERSIFY ITS EXPORT STRUCTURE, POSSIBLY BY ENCOURAGING FOREIGN INVESTMENT IN THIS AREA. MOREOVER, N.Z. TENDENCY TO BLAME HIGH DOMESTIC INFLATION ON IMPORT PRICES SHOULD BE SEEN IN LIGHT OF ITS COMMITMENT TO FULL LIMITED OFFICIAL USE

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EMPLOYMENT. PERHAPS N.Z. SHOULD BE WILLING TO ACCEPT 1 PERCENT UNEMPLOYMENT IN INTERESTS OF STABILIZATION POLICY AT TIME WHEN OTHER COUNTRIES, LIKE U.S., WERE PREPARED TO ACCEPT 7 PERCENT OR MORE TO CONTROL PRICE SPIRAL (WHICH HELPS REDUCE N.Z. IMPORT PRICES). IN ADDITION, PRICE STABILIZATION WOULD MAKE EXPORTS MORE COMPETITIVE AND STRENGTHEN PRIVATE CONSUMPTION. THUS, GERMAN DEL THOUGHT THAT PRICE STABILIZATION MIGHT BE PREFERABLE TO DOMESTIC DEMAND STIMULATION. IN REPLY, N.Z. DEL AGREED THAT PRICE STABILITY WAS IMPORTANT OBJECTIVE. HE ALSO AGREED THAT STRUCTURAL CHANGES WERE NECESSARY, BUT NOTED SHORTAGE OF CAPITAL TO CARRY OUT NECESSARY INVESTMENTS. HE RECOGNIZED THAT FOREIGN INVESTMENT COULD ASSIST IN THIS PROCESS AND THOUGHT N.Z. MIGHT HAVE TO RELY MORE ON THIS SOURCE OF CAPITAL IN FUTURE, (SEE PARA 10 BELOW), PARTICULARLY IN VIEW OF RENEWED TERMS OF TRADE DETERIORATION SINCE 1973.

7. BALANCE OF PAYMENTS: N.Z. EXPECTS SMALL INCREASE IN EXPORT VOLUMES AND LARGE DECREASE IN IMPORT VOLUMES (-20 PERCENT) TO RESULT IN REDUCED CURRENT ACCOUNT DEFICIT IN 1975, DESPITE CONTINUED WORSENING OF TERMS OF TRADE. CURRENT ACCOUNT DEFICIT EXPECTED TO BE ABOUT \$450-500 MILLION IN 1975-76, ABOUT HALF OF ESTIMATED \$950 MILLION DEFICIT IN 1974/75, WHICH IS, ACCORDING TO N.Z. DEL, "AN ACCEPTABLE PRICE TO PAY FOR FULL EMPLOYMENT." ON EXPORT SIDE, GNZ IS ACTIVELY PROMOTING SALES OF LAMB IN MIDDLE EAST AND IS EXPLORING PROSPECTS FOR BILATERAL DEALS WITH SOCIALIST COUNTRIES (E.G. RUSSIAN OIL FOR N.Z. WOOL). MAIN HOPE FOR EXPORTS, HOWEVER, LIES IN RAPID RECOVERY OF MAJOR INDUSTRIAL ECONOMIES.

8. N.Z. IS CONFIDENT THAT DEFICITS CAN BE FINANCED NEXT YEAR BY DRAWINGS ON IMF CREDIT TRANCHES, AND BORROWINGS ON INTERNATIONAL CAPITAL MARKET. IF DEFICIT IS LARGER THAN ANTICIPATED, HOWEVER, N.Z. DEL HOPED THAT WORLD COMMUNITY (WHICH WAS RESPONSIBLE FOR TRADE FLUCTUATIONS) WOULD PROVIDE NECESSARY FINANCING FACILITIES (E.G. OECD FINANCIAL SUPPORT FUND) SO THAT N.Z. WOULD BE ABLE TO

RESPECT ITS COMMITMENTS UNDER TRADE PLEDGE. IN MEANTIME,
GNZ DOES NOT INTEND TO PUT ON ADDITIONAL IMPORT CONTROLS
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DESPITE CALLS FOR SUCH MEASURES IN N.Z. NOR DOES N.Z.
SEE MUCH SCOPE FOR LIBERALIZATION OF EXISTING IMPORT
CONTROLS UNDER PRESENT INTERNATIONAL TRADE CONDITIONS.

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SP-02 TRSE-00 CIEP-01 LAB-04 SIL-01 OMB-01 STR-01

AGR-05 XMB-02 L-02 /083 W
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N.Z. DEL NOTED THAT INDUSTRIAL COUNTRIES WERE QUICK
TO PUT UP BARRIERS AGAINST AGRICULTURAL PRIMARY PRODUCTS
FOR DOMESTIC POLICY REASONS, AND IT WAS NOT SURPRISING
IN SUCH A PROTECTIONIST WORLD THAT N.Z. HAD BEEN SLOW TO
DISMANTLE ITS OWN IMPORT CONTROLS ON MANUFACTURED GOODS.
AS LONG AS TRADING RULES FOR AGRICULTURAL AND MANUFACTUR-
ING PRODUCTS WERE SO DIFFERENT, THERE WOULD BE LITTLE

CHANCE OF TRADE LIBERALIZATION. DESPITE THIS, N.Z. IS STRIVING TO INCREASE EFFICIENCY OF ITS OWN MANUFACTURING INDUSTRIES SO THAT NEED FOR IMPORT CONTROLS CAN BE REDUCED.

9. EDRC SUGGESTED THAT EXTERNAL POSITION COULD BE IMPROVED BY INTEREST RATE POLICY DESIGNED TO ENCOURAGE CAPITAL INFLOWS, BUT THIS WAS REJECTED BY N.Z. DEL AS INCONSISTENT WITH TRADITIONAL LOW INTEREST RATE STRUCTURE. EDRC ALSO SUGGESTED THAT N.Z. HAD PERHAPS LIVED BEYOND ITS MEANS IN 1972-74 AND HAD MISSED OPPORTUNITY TO BUILD UP ITS RESERVES WHEN TERMS OF TRADE WERE BRIEFLY IN ITS FAVOR IN 1971-73.
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10. ENERGY PROSPECTS AND FOREIGN INVESTMENT POLICY: N.Z. EXPECTS OFFSHORE GAS AND OIL PRODUCTION TO PROVIDE ALMOST 40 PERCENT OF DOMESTIC ENERGY NEEDS BY 1985, WHICH WILL PERMIT N.Z. TO REDUCE ITS DEPENDENCE ON IMPORTED OIL FROM PRESENT 60 PERCENT TO 30 PERCENT OF TOTAL ENERGY SUPPLY (REMAINDER PRESUMABLY FROM OTHER SOURCES). THERE ARE NO RESTRICTIONS ON FOREIGN INVESTMENT IN PETROLEUM EXPLORATION, BUT GNZ WOULD WANT 50 PERCENT EQUITY SHARE IN EXPLOITATION. N.Z. DEL RECOGNIZED USEFUL CONTRIBUTION OF FOREIGN INVESTMENT TO N.Z. DEVELOPMENT, BUT NOTED ANTIPATHY IN HIS COUNTRY TOWARD SPECIAL INCENTIVES WHICH "DISCRIMINATE" IN FAVOR OF FOREIGN INVESTORS. EXISTING APPARATUS FOR CONTROL OF FOREIGN OWNERSHIP IS INTENDED TO ASSURE N.Z. SHARE IN INVESTMENTS.
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Message Attributes

Automatic Decaptioning: X
Capture Date: 01 JAN 1994
Channel Indicators: n/a
Current Classification: UNCLASSIFIED
Concepts: ANNUAL REPORTS, ECONOMIC REPORTS
Control Number: n/a
Copy: SINGLE
Draft Date: 17 MAR 1975
Decaption Date: 01 JAN 1960
Decaption Note:
Disposition Action: RELEASED
Disposition Approved on Date:
Disposition Authority: MorefiRH
Disposition Case Number: n/a
Disposition Comment: 25 YEAR REVIEW
Disposition Date: 28 MAY 2004
Disposition Event:
Disposition History: n/a
Disposition Reason:
Disposition Remarks:
Document Number: 1975OECDP06805
Document Source: CORE
Document Unique ID: 00
Drafter: n/a
Enclosure: n/a
Executive Order: N/A
Errors: N/A
Film Number: D750093-0068
From: OECD PARIS
Handling Restrictions: n/a
Image Path:
ISecure: 1
Legacy Key: link1975/newtext/t19750344/aaaabnms.tel
Line Count: 313
Locator: TEXT ON-LINE, ON MICROFILM
Office: ACTION EUR
Original Classification: LIMITED OFFICIAL USE
Original Handling Restrictions: n/a
Original Previous Classification: n/a
Original Previous Handling Restrictions: n/a
Page Count: 6
Previous Channel Indicators: n/a
Previous Classification: LIMITED OFFICIAL USE
Previous Handling Restrictions: n/a
Reference: 75 USOECD 4744
Review Action: RELEASED, APPROVED
Review Authority: MorefiRH
Review Comment: n/a
Review Content Flags:
Review Date: 14 MAY 2003
Review Event:
Review Exemptions: n/a
Review History: RELEASED <14 MAY 2003 by ElyME>; APPROVED <15 MAY 2003 by MorefiRH>
Review Markings:

Margaret P. Grafeld
Declassified/Released
US Department of State
EO Systematic Review
05 JUL 2006

Review Media Identifier:
Review Referrals: n/a
Review Release Date: n/a
Review Release Event: n/a
Review Transfer Date:
Review Withdrawn Fields: n/a
Secure: OPEN
Status: NATIVE
Subject: EDRC ANNUAL REVIEW OF NEW ZEALAND
TAGS: ECON, NZ, OECD
To: STATE
Type: TE
Markings: Margaret P. Grafeld Declassified/Released US Department of State EO Systematic Review 05 JUL 2006